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Financial Management Issues Of The '80s

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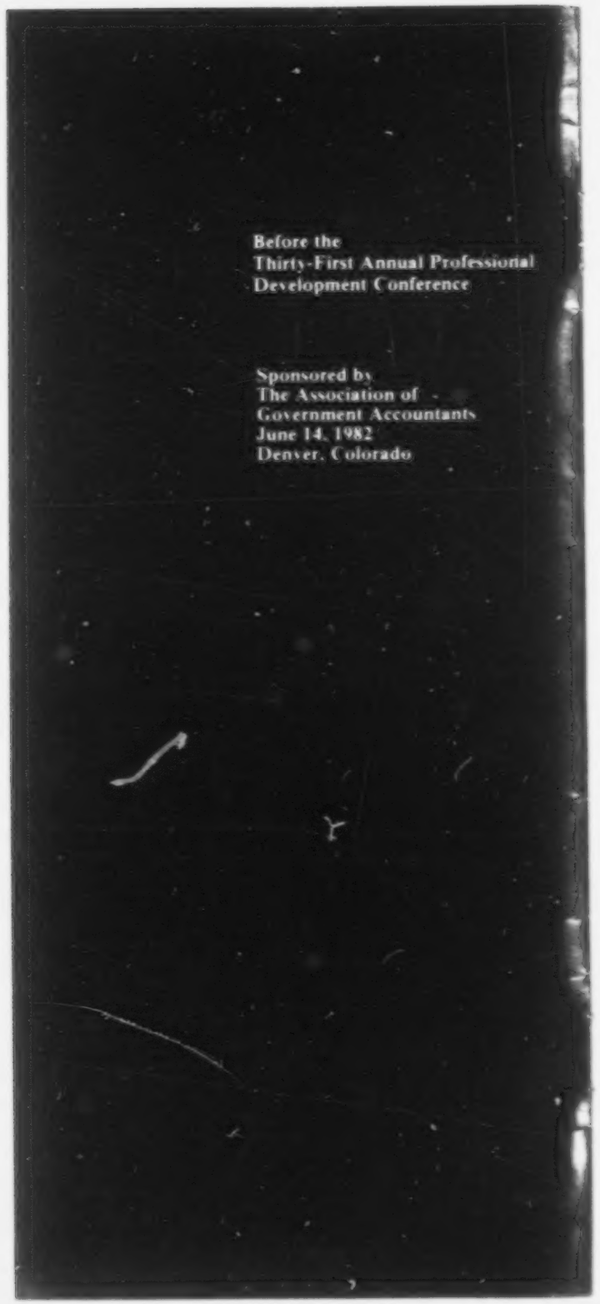

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Financial Management Issues Of The '80s

by
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It is a great pleasure to address the annual professional development conference of the Association of Government Accountants -- an organization that I have worked with for the past 15 years. Today, I would like to discuss some of the problems I perceive in the way the Federal government conducts its business. I would also like to provide you with a GAO perspective on ways we in the financial management community can attempt to solve them. There is no question that improvements have been made in recent years but some major problems remain with us that urgently need our attention.

What is the current status of financial management in government? To arrive at an answer to this complex question, let's start with the budget process. There is a growing recognition that something has to be done to reduce the complexity of the budget process of the Federal government. Cumbersome budget concepts and procedures must be overhauled. The Federal budget process was last examined comprehensively in 1967. Since then, the size of the budget and the number of programs it supports have dramatically increased, severely straining the capacity of the overall budget system to adequately serve decision makers.

Congress is finding it more and more difficult to use budget information to assess program results and set national priorities. This situation has resulted from several major factors including the rapid rate of budgetary growth, incomplete budget coverage stemming from the exclusion of off-budget items, extensive growth in the less controllable aspects of the budget, namely, entitlement programs, and proliferation of budgetary accounts -- 1,200 accounts and 5,000 programs.

The national debt is now over $1 trillion and the interest on that debt requires over $100 billion every year. Com-

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bined Federal, State and local budgets are about to exceed $1 trillion a year.

Monitoring and accounting for the expenditures of vast sums of Federal money pose a challenge for the financial management profession that is unprecedented. The nation's proposed military spending budget provides an appropriate illustration. It is projected that the Defense Department will "spend" $1.5 trillion over the next 5 years. It is, by far, the largest single department expenditure and raises the question as to whether the financial management systems within the Department of Defense are capable of accounting for and controlling these enormous expenditures. GAO is being asked by "doves" and "hawks" alike to help ensure that the $1.5 trillion will be spent efficiently and effectively.

At the Federal level, the General Accounting Office has not yet approved accounting systems that relate to expenditures of more than half the budget. Accounting systems for most appropriations and funds of the Department of Defense and Health and Human Services have never been approved. Yet, current congressional and executive budgetary debates highlight considerable frustration regarding trade-offs between social and defense expenditures.

In contrast to the situation at the Federal level, progress in the development of accounting systems by some States, cities, and counties has been good, especially since 1975—the year of the New York City crisis. This suggests that there are some lessons to be learned there that should be considered for making improvements at the Federal level.

Setting Accounting Principles and Standards for the Public Sector

Setting accounting principles and standards for the public sector is one of the most important issues facing the financial management profession. The Congress has given the GAO the responsibility for setting the principles and standards for Federal agencies that will serve the accounting disclosure needs of the Congress, Federal managers, and the public as effectively as possible. While progress has been made by the National Council on Government Accounting for the State and local level, it is generally agreed that there is need for a governmental standard setting body similar to that in the private sector.

Currently, GAO is developing a conceptual framework under which existing accounting principles and standards

can be examined. Using the conceptual framework, we will analyze the current principles and standards and revise them where necessary. Our objective is to determine what financial reporting disclosure should be made and to whom it should apply after we have seriously considered the relevance, reliability, and costliness of information.

Our long-range goal is to incorporate the accounting principles and standards of the Financial Accounting Standards Board and the Governmental Accounting Standards Board (the proposed standard-setting body for the State and local governments) to the extent possible as they could apply to the Federal sector.

GAO continues to provide full support to the objective of the Governmental Accounting Standards Board. We recognize the need for a close working relationship and a spirit of cooperation between GASB and FASB.

Establishing Effective Internal Controls

One common denominator of all financial systems is internal controls. A strong system of internal controls is one of the most cost-effective tools to improve financial management. While effective internal controls have been mandated by law for over 30 years, they are weak in many Federal systems. In fact, a seemingly unending disclosure of fraud, waste, and abuse in government in the past decade has led to a serious crisis of confidence in government programs and agencies. This situation resulted, in no small measure, from hastily designed and implemented Federal programs.

In the past, internal controls were regarded as the exclusive province of accountants and auditors. Now they are viewed as the basis for all aspects of management control and are the key to improving the efficiency and effectiveness of government functions and programs.

Although the Office of Management and Budget has recently issued a policy statement on internal controls, GAO believes that this matter is of such significance that it should be legislatively required. Past experience has demonstrated that progress will require great perseverance and continuous top managment attention. A law will provide the required permanence, priority, and continuity whereas a circular can be modified or rescinded as administrations come and go. Legislation requiring an annual

report signed by the agency head would also provide for greater public visibility and scrutiny of the agency's programs in strengthening internal controls. OMB's circular does not provide for such a report.

With the support of AGA, GAO and others in the financial community, Congress has proposed such legislation—The Federal Managers' Accountability Act of 1981 which passed the House, and the Financial Integrity Act, which is now before the Senate. Both acts will establish internal controls as a high priority issue.

How will this legislation work? In each Federal agency it would consist of three main phases:

- An initial review of its internal accounting and administrative control strengths and weaknesses;
- A plan of action to strengthen internal accounting and administrative controls; and
- An annual review of the prior year's progress in achieving the planned internal control improvements and an analysis of current control systems—including an update of the current plan of action.

We at GAO strongly support this legislation and believe it will go a long way to providing the policy and procedural framework needed to make the necessary strides to improve internal controls in Federal systems.

Inspectors general should play a significant role in the implementation of the internal control legislation because of their continuing responsibility to assess agency accounting and administrative control systems. The GAO, in its oversight role, will work closely with the inspectors general regarding these reviews. We believe that a close working relationship will greatly facilitate the resolution of many long standing problems that exist in our accounting systems approval process.

Approving Accounting Systems

What can be done about the accounting approval process? As a result of past experiences in approving accounting systems, we have decided to restudy the GAO approach. I believe we have directed too much of our effort to review of design documentation rather than on the accounting system after it is placed in operation. We want to determine what improvements can be made so that agencies will be motivated to seek approval. Some of the major problems we have encountered involve agencies which install and operate systems that do not meet our standards. They are then reluctant to make the necessary changes or will change the design documentation but not the actual system. In many cases, accounting systems are not operating properly because of failure to implement an approved design or because internal controls have become weak or practically nonexistent.

Most of these problems could be resolved by the proposed legislation which would require agencies to include in their plan of action the progress made in obtaining approval of accounting systems in accordance with GAO's standards. The role of the inspectors general in reviewing this plan—combined with GAO's oversight responsibility—should help resolve problems of accounting systems approval.

We will defer making a final decision to change or not change our approval policy until after the internal control legislation has passed and we have had sufficient time to review the actual results for some period of time. In other words, we want to test the effectiveness of the new internal control review process. Meanwhile, we are consulting with top financial managers within the Government, the public accounting sector, automatic data processing consulting firms, and academia to obtain ideas on how to improve this effort.

Integrating Budgeting with Accounting

Another matter of great concern to the financial management profession is the urgent need to integrate accounting and budgeting systems. This need becomes even more essential if the balanced budget constitutional amendment is passed by the Congress. For example, recently within the same week that substantial support for the balanced budget amendment became evident, people started talking about excluding the Social Security program from the budget. Let us hope that in the 1980s the Federal government will not duplicate the New York City errors of the mid-70s. There was a "balanced budget" amendment in New York too. Creative budget and accounting were used to circumvent the "balanced budget" requirement.

An excellent example of inadequate budgetary and accounting procedures at the Federal level is contained in

the recent GAO audit of the Defense budget increase of $72 billion between 1980 and 1982. The significant areas of concern dealt with critical questions of military readiness and sustainability, modernizing the forces, and improving the quality of life for military personnel. The lack of integration between the accounting and budgeting systems was one of the major problems noted in our report.

At the base level, the relationship between funds expended and readiness was not always readily apparent. For example, funds to enhance readiness were used to buy and insert simulated redwood slats in chain link fencing. At another location, funds were used to build a new gate house, visitors center, and parking area.

It has been 15 years since the last comprehensive examination of the budget process and nearly 8 years since the Congressional Budget and Impoundment Control Act became law.

New concepts and procedures will be particularly difficult to formulate because they will have impact on both congressional and executive branch decisionmaking. For example, the Congress often finds itself dealing with three sets of figures—House, Senate, and OMB—all supposedly accurate. As a result, I believe there is now a critical need to establish a high level study group or commission to act as a catalyst to bring about major changes in the budget process. Meanwhile, continued efforts should be made to establish a closer relationship between accounting and budgetary systems.

Several States, cities and counties have made major investments in the integration and modernization of these functions. In doing so, these States and local governments have initiated a major effort to rekindle the public's belief that governmental entities can truly account for and report on all funds. There are several vital reasons why financial management systems at all levels of government need to follow this course of action. These reasons include the need to provide assurance that the budget is executed according to spending plans and that all funds, including grants, are accounted for.

Implementing the Single Audit Concept

Improvements in accounting and budgeting systems are not sufficient by themselves. Decision makers and the public must also be provided with assurance that the systems

are working as intended and that there is full disclosure of operating and financial results at all levels of government.

Reliance on audit as a major accountability mechanism will become increasingly important as greater responsibility and authority are passed on to the State and local levels, and as traditional forms of Federal agency oversight—application review, monitoring and detailed reporting—are deemphasized. This trend is most apparent, of course, in the proposals for "New Federalism" and the move toward block grants.

Substantial improvements in the audit process must be achieved. The need to improve audit coverage on a more cost-effective basis is vital. Although much effort in the past has been expended on audits of federally assisted programs to States and local governments, there is serious question regarding their effectiveness. GAO reports have indicated that many Federal grant expenditures are not audited. In addition, there was subtantial duplication of audit effort for individual grants that were audited.

I view the concept of a single audit on an entity basis to be superior to the more common practice of auditing on a grant-by-grant basis. I believe it is fair to say that the Federal government gave birth to the single audit concept rather hastily without ensuring that the proper framework was in place to guarantee its success. There is a great need to sort out many issues, the most important of which is reaching agreement on a common definition of what constitutes a single audit.

While GAO fully supports the single audit concept, there are some crucial issues yet to be resolved.

- How will we get a mutual understanding of the expectations to be derived from the single audit by all Federal, State, and local users?
- What is the role of the cognizant Federal agency in working with the auditor and auditee in agreeing on the scope of the audit?
- What is the role of the cognizant agency in testing the quality review process and how will it be performed?
- Since the single audit approach focuses on the overall financial integrity and internal control improvements, what alternative mechanisms are needed, if any, to assure possible congressional expectations concerning

compliance with the more detailed requirements of the individual grant programs?

- Is it feasible to mandate that all entities and sub-recipients be subject to the single audit? Or is it more feasible to target the initial efforts to the 50 States and 300 cities and counties?

- What is the Federal share, if any, of costs associated with the single audit?

There is a real need for leadership to come to grips with the issues which have been holding up implementation of the single audit concept. We at GAO have initiated a study to obtain an improved data base on the current condition.

We have also conducted a Single Audit Policy Conference to explore implementation problems with State and local audit officials and independent public accountants who are the persons primarily responsible for performing single audits. That conference demonstrated a very strong support for the single audit concept on the part of several State and local audit officials and by larger and smaller independent public accounting firms. They not only found the concept workable but highly desirable. There seemed to be general agreement that the single audit should be performed on an entity basis and that strengthening of internal controls is a major benefit of the approach. I believe we should be moving towards an annual entity audit especially with the States and larger cities and counties. At present, the Revenue Sharing Act of 1976 calls for an entity audit at least once every three years and for some compliance auditing with provisions of that act.

There is another significant efficiency of the single audit approach which merits our attention. It provides an improved audit base for performing additional selective audits on program reviews to satisfy specific Federal, State, and local user needs such as those concerning detailed compliance issues, and economy and efficiency or program results.

Recently, I have begun to consider whether the single audit concept could more effectively and efficiently be carried out by a single audit agency. Such an agency could have operations similar in scope to that of the Defense Contract Audit Agency. It might appropriately be established within the Treasury Department to be consistent with other Treasury responsibilities such as monitoring of

revenue sharing. I recognize, of course, that modification of existing revenue sharing or separate legislation integrating all Federal audit requirements may be required.

Training

Investment in training is critical to the maintenance of a qualified, capable and motivated staff. This is especially true in today's environment of rapid change in information technology which is a primary ingredient for improved financial management. Continuous training must be designed for all employees.

As an example, GAO is developing an improved training program to upgrade staff skills in auditing with computers. I cannot overstate how important it is that auditing keep abreast of the tremendous development and growth of computer-assisted operations. We must also have adequately trained staff to cope with the potential for ineffective and inefficient use of advanced data processing systems. In still another area, GAO plans to take the fullest advantage of new technology, such as electronic work stations, to improve GAO productivity.

Leadership

The achievement of long term improvements in financial management will be largely dependent upon the availability of leadership and qualified staff.

For example, a major issue in Federal financial management concerns the role of the assistant secretary for management/budget. Agencies have constantly changed the role and responsibility of this position which is comparable to a chief financial officer in a State or city or in one of our larger corporations. But history shows a variety of assigned responsibilities to the assistant secretary position, sometimes with the worst case being the separation of the accounting and budget functions. If progress is to be made, this key position must be clarified and made consistent so that accountability can be clearly assigned. The post should be upgraded and filled by a presidential appointee, either from the private or government sector, who has excellent professional credentials, a broad financial management background, and a demonstrated ability to assume responsibility for budgeting, accounting, and reporting systems of the departments.

Of course, one person at the top cannot do it all. There must also be sufficient numbers of highly qualified professional career service persons at all levels within the financial management organization. Obtaining highly qualified staff will be particularly difficult in this time of budgetary restraint. There will also be budgetary pressure to trim or eliminate important training programs. We must meet these challenges if the major problems in financial management are to be resolved.

Conclusion

I have attempted to recap the important financial management issues and provide my perspective on what has to be done in the next 5-10 years if we are to realize significant improvements. Considerable attention and effort must be directed to integrating our budgetary and accounting systems, improving financial reporting, and ensuring sound internal controls. The audit process must be redirected to ensure that internal control systems related to all funds are included in the audit.

How can progress be made on these important financial management issues? First and foremost we must be willing to exert necessary effort to effect positive change. Secondly, we must provide leadership and communication not only within the financial management community, but with policymakers, program managers, and the public.

We stand on the threshold of an exciting period. Major issues face us and await resolution. One thing is certain: success in financial management will not come easily, nor will we achieve it by resting on past accomplishments or outmoded methods of doing business. With commitment and leadership, the Association of Government Accountants—together with GAO—is ready to move forward. Others at the Federal, State and local levels must also join in this effort. Together we can provide the financial management expertise that is needed to recapture the support and confidence of the public. Together we can work out solutions for problems that I have discussed today. Together I am certain we can make great progress as we meet the challenges of the 80s.

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